IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

NO. 18-0121

THE HONORABLE DALE STEAGER,
West Virginia State Tax Commissioner,
THE HONORABLE JOHN L. BREEN,
Assessor of Lewis County, and
THE COUNTY COMMISSION OF LEWIS COUNTY,
Sitting as the Board of Assessment Appeals,
Respondents Below, Petitioners,

vs.

CONSOL ENERGY INC. DBA CNX GAS COMPANY LLC
Petitioner Below, Respondent

Hon. Christopher C. Wilkes
Circuit Court of Lewis County, Business Court Division
Civil Action No. 17-C-11

BRIEF OF THE RESPONDENT

Counsel for Petitioners

L. Wayne Williams, Esq.
Office of the Attorney General
State Capitol, Building 1, Room W-345
1900 Kanawha Boulevard East
Charleston, West Virginia 25305
Counsel for Dale W. Steager, West Virginia State Tax Commissioner

Counsel for Respondent

Craig A. Griffith (WVSB No. 8549)
John J. Meadows (WVSB No. 9442)
STEPTOE & JOHNSON PLLC
Post Office Box 1588
Charleston, West Virginia 25326
Telephone: (304) 353-8000
Facsimile: (304) 353-8180
E-mail: craig.griffith@steptoe-johnson.com

TABLE OF CONTENTS

Cases

Statutes

Other Authorities

Rules

Miscellaneous Materials

I. STATEMENT OF THE CASE

A. INTRODUCTION

This is the response of the Respondent, CONSOL ENERGY Inc. dba CNX Gas Company LLC (the "Respondent"), the Petitioner below, to the briefs of the West Virginia State Tax Commissioner (the "Tax Commissioner" or the "Tax Department"). Briefs were not filed by the Assessor of Lewis County (the "Assessor") or the County Commission of Lewis County sitting as a Board of Assessment Appeals (the "Lewis County BAA" and collectively with the Tax Commissioner and the Assessor, the "Petitioners").[1] The Tax Department appealed the order of the Circuit Court of Lewis County, Business Court Division (the "Circuit Court"), reversing the decision of the Lewis County BAA that upheld the valuation of Respondent's gas wells for the 2016 tax year.

Petitioners argue that the Circuit Court erred by: 1) ruling that the Tax Department incorrectly applied the Yield Capitalization Model set forth in Title 110, Series 1J of the West Virginia Code of State Rules (the "Rule" or "WV CSR § 110-1J-1 *et seq.*"); 2) creating a "hybrid" valuation methodology for producing oil and gas wells; 3) concluding that the Tax Department violated the equal and uniform clauses of the West Virginia Constitution, Article X, section 1; and 4) concluding that that Tax Department violated the Equal Protection Clause of the United States Constitution, Amendment XIV § 1.[2]

However, the Circuit Court's decision is correct in all respects, and is based on the Tax Department's use of an operating expense "cap" or "maximum amount," a concept that is simply not discussed in or permitted under the Rule. Use of the "cap" results in the Respondent's

[1] Presumably, the Assessor and Lewis County BAA agree with the arguments made by the Tax Commissioner.
[2] Petitioner's Brief at pp. 10, 18, 23.

working interest in producing natural gas wells being valued substantially in excess of the true and actual value, and also leads to a violation of the West Virginia and United States Constitutions. Because the Circuit Court properly reversed the decision of the Lewis County BAA, this Court should affirm the Circuit Court's ruling in all respects.

B. STATEMENT OF FACTS[3]

The Respondent operates natural gas wells throughout West Virginia, primarily conventional, vertical wells, including 863 in Lewis County for purposes of tax year 2016.[4]

Each year, the Tax Department determines the fair market value of the Respondent's producing natural gas wells on a statewide basis using a mass appraisal system that employs a net income approach to valuation.[5]

As required by the Tax Department, the Respondent files gross receipts information on the annual property tax return for natural gas producers, and the Tax Department reduces the receipts by a production decline rate.[6] Respondent reports gross receipts based on the point of sale for the natural gas.

After application of the production decline rate, the Tax Department calculates a net working interest income series by reducing the gross receipts by operating expenses and then applying a capitalization rate to determine market value for the working interest of the natural gas well, including personal property.[7]

---

[3] References to the Appendix Record are set forth as "AR Vol. __." All citations are to the Appendix Record submitted by the Tax Department.
[4] AR Vol. I, p. 000002; AR Vol. I, Hr'g Ex. 1, 000024-42.
[5] AR Vol. III, Transcript pp. 9:24-12:1; AR Vol. I, Hr'g Ex. 10, pp. 000302-05; AR Vol. I, p. 000002.
[6] AR Vol. III, Transcript pp. 9:24-12:8; AR Vol. I, Hr'g Ex. 10, pp. 000302-05; WV CSR § 110-1J-4.2, 4.6.
[7] AR Vol. III, Transcript pp. 6:22-7:4, 9:24-12:8; AR Vol. I, Hr'g Ex. 10, pp. 000302-05; AR Vol. I, Hr'g Ex. 8, pp. 000317-63; WV CSR 110-1J-4.6.1.

The amount of operating expenses applied to a well using the mass appraisal system is based on a percentage of the well's gross receipts, which are "capped" at a "maximum amount," and the percentage and maximum vary by the type of well (typical or conventional, Marcellus, etc.). The operating expense calculations are included in a natural resources "valuation variables" document that the Tax Department releases annually.[8] For tax year 2016, the Tax Department calculated operating expenses for conventional, vertical wells by multiplying the reported gross receipts for a well by 30%, and "caps" the amount of allowable operating expense per well at $5,000.[9]

In addition to the valuation variables document, the Tax Department releases an annual administrative notice that lists the percentages and maximum amounts for operating expense calculations. In prior years, the Tax Department invited taxpayers to submit actual operating expenses that exceed the percentages and maximum amounts listed in the valuation variables document: "In the event a producer's ordinary expense, as a direct result of production, exceeds the stated maximums for oil and gas production, the Tax Department will accept and review documentation on wells for the previous three years that is provided by the producer."[10] The 2016 administrative notice, unlike administrative notices from 2000 through 2015, however, did not include language that invites taxpayers to submit actual expenses, despite no changes to the

---

[8] AR Vol. I, Hr'g Ex. 8, pp. 000317-363.

[9] AR Vol. I, Hr'g Ex. 8, p. 000348; AR Vol. III, Transcript pp. 16:22-17:1. The Tax Department increased the average annual industry operating expense percentage for typical producing wells from 30% to 45% for tax year 2017 because of the precipitous drop in gas prices from calendar year 2014 to calendar year 2015. However, the cap of $5,000 is still in place. AR Vol. I, Hr'g Ex. 8, pp. 000317-63; AR Vol. III, Transcript pp. 17:2-7.

[10] *See, e.g.*, Administrative Notices 2015-08, 2014-08, 2013-08 and 2012-08; *see also* AR Vol. III, Transcript pp. 12:9:-13:9. The Tax Department's website includes administrative notices dating back to the year 2000, and each administrative notice for oil and gas operating expenses invites producers to submit actual operating expense information.

West Virginia Code or Title 110, Series 1J of the West Virginia Code of State Rules or "WV CSR § 110-1J-1 *et seq.*[11]

Respondent evaluated its actual operating expenses for calendar year 2014 (the year used to value wells for tax year 2016), and determined that for conventional, vertical wells in the Lewis County, the amount of operating expenses that it was incurring significantly exceeded the percentages and maximum amounts set by the Tax Department.

Respondent reported its statewide operating expenses to the Tax Department for the Tax Department's review and comparison to variables published for tax years 2016. For 2014, Respondent's average operating expenses per conventional, vertical well was 37% of gross receipts, or $5,898 per well.[12]

Applying Respondent's operating expense percentage of 37% for tax year 2016, with no "cap" on the amount of operating expense per well, would result in a value for its conventional, vertical wells in Lewis County of $18.1 million, far below the Tax Department's value of $26.7 million.[13] The Tax Department declined to consider the Respondent's actual operating expenses.

For tax year 2016, Respondent submitted to the Assessor and Lewis County BAA an application for review of property assessment with regard to its gas wells, and Respondent appeared on October 24, 2016, by counsel, before the Lewis County BAA in order to protest the Tax Department's valuation of its producing wells (as adopted by the county Assessor).[14]

Respondent presented clear and convincing evidence to the Lewis County BAA that the Tax Department failed to consider Respondent's actual operating expenses in determining the

[11] AR Vol. III, Transcript pp. 12:9-13:9, 38:18-39:2, 39:11-14.
[12] AR Vol. III, Transcript pp. 14:18-24, 16:22-17:1; AR Vol. I, Hr'g Ex. 4, pp. 000180-82.
[13] AR Vol. I, Hr'g Ex. 1, 000024-42; AR Vol. III, Transcript pp. 18:14-23.
[14] *See* W. Va. Code § 11-3-24b; *see* AR Vol. I, Hr'g Ex. 1, pp. 000024-42; AR Vol. III, Transcript.

valuation for the wells assessed for Lewis County. Respondent presented a complete analysis of its actual operating expenses, supported by written documents and testimonial evidence that correctly applied the approach to arrive at allowable operating expenses. Respondent proved by clear and convincing evidence that the Tax Department erroneously calculated average operating expenses based on 30% of gross receipts with a "cap" of $5,000 for tax year 2016, and that the Tax Department failed to assess its wells at their true and actual value.[15] Respondent demonstrated that its actual operating expenses, and the operating expenses of other members of the West Virginia Oil and Natural Gas Association ("WVONGA")[16], were far in excess of the Tax Department's allowances. Respondent showed that its actual operating expenses per conventional, vertical well were 37% of gross receipts, or $5,898, on average for tax year 2016.[17]

The Lewis County BAA made no adjustment to the Tax Department's valuation of Respondent's gas wells for the 2016 tax year.[18]

Based upon the record made at the hearing, the Circuit Court reversed the decision of the Lewis County BAA that upheld the valuation of the Respondent's gas wells for the 2016 tax year and remanded the matter back to the County Commission to set the fair market value of Respondent's wells in Lewis County for tax year 2016. The Petitioners appealed this matter to the West Virginia Supreme Court of Appeals prior to a remand of the matter to the Lewis County BAA, and the fair market value of the Respondent's wells for tax year 2016 based on application

---

[15] AR Vol. III, Transcript p. 14:18-23, and throughout; AR Vol. I, Hr'g Ex. 4, pp. 000180-82; AR Vol. I, Hr'g Ex. 1, pp. 000024-42.

[16] WVONGA, in response to the tentative valuation variables produced by the Tax Department for tax year 2017, provided public comments pursuant to a letter dated July 29, 2016. AR Vol. I, Hr'g Ex. 9, pp. 000307-000311. WVONGA's public comments included information provided by oil and gas producers who cover approximately 65% of oil and natural gas production in West Virginia. *Id.* WVONGA's calculation of the average of actual expenses per conventional well was 41% of gross receipts per well for calendar year 2015. *Id.*

[17] AR Vol. III, Transcript pp. 14:18-24, 16:22-17:1; AR Vol. I, Hr'g Ex. 4, pp. 000180-82.

[18] AR Vol. I, pp. 001485-1491.

of the Tax Department's 30% average annual industry operating expense percentage to Respondent's gross receipts without the imposition of a cap has yet to be established. The Circuit Court's order includes the following pertinent conclusions of law:

- "[T]he assessment of CNX's producing gas wells in Lewis County for Tax Year 2016 was improperly applied and is not supported by substantial evidence."[19]
- "[T]he evidence demonstrates that the Tax Department failed to assess CNX's producing gas wells at their true and actual value, and the Board's decision must therefore be reversed."[20]
- "The [Legislative] Rule contemplates a single average, which the Tax Department has calculated as 30% of gross receipts for conventional wells. However, the Tax Department imposes two 'averages,' a percent of gross receipts and a 'cap' or 'maximum amount' of $5,000 per conventional well for tax year 2016. This cap unduly restricts the amount of operating expenses that should be allowed for each well, and the imposition of a 'cap' on operating expenses is not supported by the [Legislative] Rule."[21]
- "[T]he Tax Department's approach to calculating and applying operating expenses to producing natural gas wells through use of a 'maximum amount' or 'cap' violates the requirements under Article X, section 1 West Virginia Constitution that taxation be 'equal and uniform throughout the state' and that both real and personal property 'be taxed in proportion to its value to be ascertained as directed by law.'"[22]
- "The Tax Department's methodology of applying the 'net receipts' model under the Rule [through use of the $5,000 cap] violates the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution, since it creates two disparately taxed groups within the same class of taxpayers, i.e., conventional well producers."[23]

This appeal followed.

II. SUMMARY OF ARGUMENT

The Circuit Court properly reversed the decision of the Lewis County BAA that upheld the valuation of Respondent's gas wells for the 2016 tax year.

The Circuit Court correctly determined that the Tax Commissioner violated the Rule and overvalued Respondent's producing natural gas for ad valorem property tax purposes by

[19] AR Vol. I, p. 000005.
[20] *Id.*
[21] *Id.*, at p. 000006.
[22] *Id.*
[23] *Id.*, at pp. 000009.

imposing a "cap" or "maximum amount" on the amount of operating expenses that can be applied on a per well basis.

Additionally, the Circuit Court correctly determined that the Tax Commissioner violated: 1) the West Virginia Constitution by failing to "equally and uniformly" value all producing conventional oil and gas wells throughout the State of West Virginia and by failing to value Respondent's conventional oil and gas wells in proportion to their value and 2) the Equal Protection Clause of the United States Constitution by treating similarly situated taxpayers differently.

Accordingly, the Respondent respectfully requests that this Court affirm the order of the Circuit Court reversing the decision of the Lewis County BAA that upheld the valuation of Respondent's gas wells for the 2016 tax year.

III. STATEMENT REGARDING ORAL ARGUMENT AND DECISION

The Respondent requests Rule 20 Oral Argument, pursuant to W. Va. R. App. P. 20, because this matter presents an issue of first impression regarding the Tax Department's methodology regarding *ad valorem* property taxation of producing oil and natural gas wells.

IV. ARGUMENT

A. STANDARD OF REVIEW

"[J]udicial review of a decision of a board of equalization and review regarding a challenged tax assessment valuation is limited to roughly the same scope permitted under the

West Virginia Administrative Procedures Act, W. Va. Code ch. 29A."[24] "In such circumstances, a circuit court is primarily discharging an appellate function little different from that undertaken by [the West Virginia Supreme Court of Appeals. . ..]; consequently, [the West Virginia Supreme Court of Appeals'] review of a circuit court's ruling in proceedings under § 11-3-25 [the statute addressing appeals of Board of Equalization and Review and Board of Assessment Appeal decisions to circuit court] is *de novo*.[25] While we are aware of no decisions of this Court that analyze a board of assessment appeals, the standard of review discussed under this section should apply equally to both boards of equalization and boards of assessment appeals.

Generally, the taxpayer's burden before the board of equalization and review or board of assessment appeals is to show by clear and convincing evidence that the valuation, and assessment, of its property is erroneous.

> 5. "As a general rule, there is a presumption that valuations for taxation purposes fixed by an assessor are correct.... The burden is on the taxpayer challenging the assessment to demonstrate by clear and convincing evidence that the tax assessment is erroneous." Syllabus point 2, in part, *Western Pocahontas Properties, Ltd. v. County Commission of Wetzel County*, 189 W. Va. 322, 431 S.E.2d 661 (1993).
>
> 6. "A taxpayer challenging an assessor's tax assessment must prove by clear and convincing evidence that such tax assessment is erroneous." Syllabus point 5, in part, *In re Tax Assessment of Foster Foundation's Woodlands Retirement Community*, 223 W. Va. 14 , 672 S.E.2d 150 (2008).[26]

However, as noted by the Court in *In Re Tax Assessments Against Pocahontas Land Co.*, 172 W. Va. 53, 61, 303 S.E.2d 691, 699 (1983), "there must be a proper assessment before there

---

[24] *In re Tax Assessment Against American Bituminous Power Partners, L.P.*, 208 W. Va. 250, 255, 539 S.E.2d 757, 762 (2000) (footnote omitted).

[25] *Cf. Wheeling-Pittsburgh Steel Corp. v. Rowing*, 2015 W. Va. 286, 293, 517 S.E.2d 763, 770 (1999)." *See also* Syl. Pt. 1, *Appalachian Power Co. v. State Tax Dep't*, 195 W.Va. 573, 466 S.E.2d 424 (1995) (holding that "[i]nterpreting a statute or an administrative rule or regulation presents a purely legal question subject to de novo review.").

[26] Syl. pts. 5-6, *Stone Brooke Limited Partnership v. Sisnni*, 224 W. Va. 691, 688 S.E.2d 300 (2009); *See also Century Aluminum of West Virginia v. Jackson County Comm'n*, 229 W. Va. 215, 728 S.E.2d 99 (2012).

can be a presumption that the assessment is correct, and where it appears that there was no proper assessment there can be no presumption in favor of the correctness of the assessment." Furthermore, "[p]ursuant to *In Re [Tax Assessments Against] Pocahontas Land Co.*, [citation omitted] once a taxpayer makes a showing that tax appraisals are erroneous, the Assessor is then bound by law to rebut the taxpayer's evidence."[27]

Generally, in regards to ad valorem property taxation challenges, this Court will not reverse an assessment made by a board of equalization and review [or board of assessment appeals] and approved by the circuit court when the assessment is supported by substantial evidence unless plainly wrong.[28]

Here, the Circuit Court reversed the decision of the Lewis County BAA, finding that the assessment of Respondent's producing gas wells in Lewis County for Tax Year 2016 was improperly applied and was not supported by substantial evidence. The number of decisions from this Court involving a Circuit Court reversal or modification of an assessment confirmed by a board of equalization and review or board of assessment appeals is sparse. However, in *Liberty Coal Co. v. Bassett*, 108 W. Va. 293, 150 S.E. 745 (1929), the Circuit Court of Marshall County modified a valuation of a board of equalization and review, and this Court determined that it had a "duty to uphold the lower tribunal [the circuit court] if there is substantial evidence for the foundation of its judgment unless it is plainly wrong."[29] The Respondent urges this Court to apply the foregoing standards to this case, and uphold the decision of the Circuit Court because it

[27] *Mountain Am., LLC v. Huffman*, 224 W. Va. 669, 786 n.23, 687 S.E.2d 768, 785 n.23 (2009).
[28] Syl. Pt. 1, *Century Aluminum*, 229 W. Va. at 216, 728 S.E.2d at 100 (2012).
[29] *See also* Syl Pt. 1, *In re Union Carbide Corp.*, 157 W. Va. 631, 203 S.E.2d 370 (1974) ("This Court will not reverse an order of a circuit Court by which the valuation for taxation purposes of. . . property was reduced on. . . appeal except (for) an error of law, or where the court's action was clearly not supported by a preponderance of the evidence.") (Citing Syllabus pt. 2, *Western Maryland Railway Company v. The Board of Public Works*, 124 W. Va. 539, 21 S.E.2d 683 (1942)). *Accord Kline v. McCloud,* 174 W. Va. 369, 326 S.E.2d 715 (1984).

is based on the substantial evidence presented at the Lewis County BAA hearing and is not "plainly wrong" or based on an "error of law."

B. METHODOLOGY USED FOR VALUATION OF PRODUCING OIL AND GAS WELLS

W. Va. Code § 11-1C-10 (d) requires the Tax Commissioner to determine the fair market value of all natural resource property[30] in the state.[31]

West Virginia Code § 11-3-1 (a), which applies to property tax assessments generally, requires that all property, except public service business property, be assessed annually as of July 1 at sixty percent of its *true and actual value*, which is defined as "the price for which such property would sell if voluntarily offered for sale by the owner thereof, upon such terms as such property, the value of which is sought to be ascertained, is usually sold, and not the price which might be realized if such property were sold at a forced sale."[32]

This Court has interpreted the term "value" with respect to tax assessments as meaning "'worth in money' of a piece of property – its market value."[33] Furthermore, the Court stated that "we have held that '[t]he price paid for property in an arm's length transaction, while not conclusive, is relevant evidence of its true and actual value.'"[34] All three cited cases discuss "true and actual value" in the context of W. Va. Code § 11-3-1.

---

[30] "Natural resources property" includes oil and natural gas. W. Va. Code § 11-1C-10(a)(2).

[31] W. Va. Code § 11-1C-10 (d).

[32] While § 11-3-1(a) discusses assessments generally, new article 6K was added to Chapter 11 of the West Virginia Code in 2010 to provide guidance regarding industrial and natural resources property assessments specifically. Much of the guidance under W. Va. Code § 11-6K-1 *et seq.*, is procedural; however, W. Va. Code § 11-6K-1(a) mirrors § 11-3-1(a) by requiring that natural resources property be assessed annually at sixty percent of its "true and actual value." Unlike § 11-3-1, § 11-6K-1 does not include a definition for true and actual value.

[33] *In re Tax Assessment of Foster Foundation's Woodlands Retirement Community*, 223 W. Va. 14, 672 S.E.2d 150 (2008) (quoting Syl. Pt. 3, in part, *Killen v. Logan County Comm'n*, 170 W. Va. 602, 295 S.E.2d 689 (1982)).

[34] *Id.* at 223 W. Va. at 33, 672 S.E.2d at 169 (quoting Syl. Pt. 2, in part, *Kline v. McCloud*, 174 W. Va. 369, 326 S.E.2d 715 (1984)).

While the West Virginia Code requires the Tax Commissioner to value producing oil and gas properties throughout the State, and provides detailed guidance as to procedural issues, little statutory guidance is given in regards to how the value is determined for purposes of W. Va. Code § 11-6K-1 (a). Instead, the detailed process for valuing producing oil and gas properties is found in the Rule, which was promulgated by the Tax Commissioner and approved by the state legislature in 2005, and which explains in detail the procedure to be utilized in valuing producing and reserve oil and gas property for property tax purposes.

Per § 2 of the Rule, if the oil or natural gas is owned separately, such as a reservation of oil and natural gas, then it is taxed separately as real property. If the oil or natural gas is owned through a leasehold interest, then the leasehold interest is taxed separately as tangible personal property.[35]

Under § 4.1 of the Rule, oil and/or natural gas producing property is valued through the process of applying a yield capitalization model to the ***net receipts (gross receipts less royalties paid less operating expenses)*** for the working interest and a yield capitalization model is also applied to the gross royalty payments for the royalty interest. The methodology required by § 110-1J-4.1 is reflected in Administrative Notice 2016-02, in which the Tax Commissioner states that the Tax Department primarily relies upon the income approach in valuing producing oil and gas property. West Virginia State Tax Department Administrative Notices 2016-02, "Property Tax: State Tax Commissioner's Statement Concerning Primary Reliance on the Income Approach to Value for Appraisals of Producing and Reserve Coal, Producing Oil and Gas, and Producing Other Mined Minerals Pursuant to §§ 110 CSR 1I-4, 1J-4 and 1K-4." As noted in the administrative notice, "the income approach to value is based upon the assumption

[35] The producing natural gas properties at issue in this matter are leased from the mineral owner by Respondent, and are assessed and taxed as tangible personal property.

that a property is worth the future income, discounted to present worth, that it will generate for a perspective [sic] buyer."

The mechanics of the yield capitalization are found under § 4.6 of the Rule. The model uses as a beginning point and includes for each producing well, the gross receipts (both working interest and royalty interest) and production amounts based on those gross receipts from the most recent consecutive three full production calendar years preceding the July 1 assessment date. These amounts are weighted average (sum of years digits) and then adjusted for production decline[36] to reflect the income available to the property owner beginning with the July 1st assessment date to June 30 next succeeding the assessment date. Gross receipts and production amounts are proportionately reduced by application of the appropriate production decline rate to yield a declining terminal income series typical of the producing area and strata. The income series is then apportioned to the working interest and to the royalty interest based upon percentage interests referenced in subsection 4.2 of the Rule. Where the well did not produce during the entire calendar year, the gross receipts and royalties paid will be annualized prior to the process of applying a yield capitalization procedure.

Under § 4.6.1 of the Rule, "the working interest weighted average (sum of years digits) gross receipts income series referenced in subsection 4.6 of [the] rule *shall be reduced by the annual operating expenses* referenced in section 4.3 of [the] rule to yield a net working interest income series. The net working interest income series shall be discounted by applying, on an annual basis, a mid-year life Inwood factor reflecting the capitalization rate referenced in section

[36] Under § 4.4 of the Rule, every five years the Tax Commissioner derives and reports the average industry production decline rates by reviewing well production records of various State agencies along with data provided by company and individuals. The Tax Department separates the decline rate info based on region and formation.

4.5 of [the] rule. *The summation of the annual discounted income streams shall be the market value estimate for the working interest of the producing oil and/or natural gas well including personal property as defined by section 3 of [the] rule.*"[37] "'Personal property' used in oil or natural gas production means *machinery and equipment in and about the well and all other tangible personal property used in oil and/or natural gas production from the well to the fieldline point of sale. It shall not include vehicles or other tangible personal property not permanently used in production.*"[38]

Operating expenses are "those ordinary expenses which are directly related to the maintenance of production of natural gas and/or oil. These expenses do not include extraordinary expenses, depreciation, ad valorem taxes, capital expenditures, or expenditures relating to vehicles or other tangible personal property not permanently used in the production of natural gas or oil."[39] While the Rule does not expound upon what kinds of expenses are "directly related to the production of natural gas and/or oil," the definition of "[g]ross receipts" under the Rule tracks total income from production on any well "at the field line point of sale" during a calendar year before subtraction of any royalties and/or expenses. Since the "field line point of sale" is the measuring point for determination of gross receipts for purposes of valuing the well and personal property connected to the producing well, it is also the measuring point for determination of which expenses are considered ordinary expenses for the maintenance and production of natural gas and/or oil, and any operating expenses incurred between the wellhead and the field line point of sale should be used to value the well.

---

[37] WV CSR § 110-1J-4.6.1 (Emphasis added.)
[38] WV CSR § 110-1J-3.18 (Emphasis added).
[39] WV CSR § 110-1J-3.16.

Every five years the Tax Commissioner determines operating expenses per well.[40] The Tax Department circulates a survey to oil and natural gas producers statewide in order to calculate the average operating expenses for various wells, which the Tax Department uses in valuing the property for producing oil and natural gas wells, with the last survey prior to the Lewis County BAA hearing having been circulated in 2014. By July 1 of each year, the Tax Department releases tentative Annual Valuation Variables, and invites public comment on the tentative variables. Included in the valuation variables are the operating expense component, which is determined through a review of responses to the survey and through use of other market data. The annual operating expenses for producing oil and gas wells for tax year 2016 are included in the final valuation variables released by the Tax Department.[41]

The Tax Department issued an administrative notice that echoes the information set forth in the Annual Valuation Variables released by the Tax Department for tax year 2016, and sets forth the estimated direct ordinary operating expenses for various types of wells. West Virginia State Tax Department Administrative Notices 2016-08, "Property Tax: State Tax Commissioner's Statement for the Determination of Oil and Natural Gas Operating Expenses for Property Tax Purposes for Tax Year 2016, Pursuant to § 110 CSR 1J.4.3." The administrative notice is silent in regards to whether the Tax Department will consider "actual operating expenses."[42] However, as noted above, in prior administrative notices discussing operating expenses for oil and gas wells, the Tax Department expressly invited taxpayers to provide such information. The Tax Department's website includes administrative notices dating back to the year 2000, and each administrative notice for oil and gas operating expenses invites producers to

---

[40] WV CSR § 110-1J-4.3.
[41] *See* Valuation Variables, AR Vol. I, Hr'g Ex. 8, pp. 000317-63.
[42] AR Vol. III, Transcript pp. 12:9-13:9, 38:18-39:2, 39:11-14.

submit actual operating expense information.[43] Consistent with the instructions for prior years, Respondent provided its actual operating expense information to the Tax Department.[44]

Throughout the appeal process, Respondent has not disputed the Tax Department's use of a net receipts model to determine the true and actual value of its producing natural gas wells. However, the Circuit Court correctly held that the Tax Department is misapplying certain aspects of the net receipts model, specifically in regards to the calculation and application of operating expenses, resulting in overvaluation of Respondent's wells, as discussed in detail, below.

C. THE CIRCUIT COURT DID NOT CREATE A "HYBRID RULE" BUT INSTEAD CORRECTLY DETERMINED THAT THE TAX COMMISSIONER CALCULATED AN OVERINFLATED "TRUE AND ACTUAL VALUE" OF RESPONDENT'S PRODUCING NATURAL GAS FOR AD VALOREM PROPERTY TAX PURPOSES BY IMPOSING A "CAP" OR "MAXIMUM AMOUNT" ON THE AMOUNT OF OPERATING EXPENSES THAT CAN BE APPLIED ON A PER WELL BASIS, IN VIOLATION OF WEST VIRGINIA CODE OF STATE RULES § 110-1J-1 *ET SEQ.*

For purposes of valuing producing operating oil and gas properties throughout the state, the Tax Commissioner is required to "every five (5) years, determine the average annual industry operating expenses per well. The average annual industry operating expenses shall be deducted from working interest gross receipts to develop an income stream for application of a yield capitalization procedure."[45]

The Rule contemplates a single average, which the Tax Department has calculated as 30% of gross receipts for conventional, vertical wells. However, the Tax Department arbitrarily takes an unauthorized liberty and imposes a "cap" or "maximum amount" of $5,000 per conventional, vertical well for tax year 2016.[46] The Circuit Court correctly determined that this

---

[43] *See, e.g.*, Administrative Notices 2015-08, 2014-08, 2013-08 and 2012-08; *see also* AR Vol. III, Transcript pp. 12:9:-13:9.
[44] AR Vol. I, Hr'g Exs. 3, 4, 5, 6, pp. 000057-000297; AR Vol. III, pp. 13:6-9, 13:14-16:14.
[45] WV CSR § 110-1J-4.3.
[46] AR Vol. III, Transcript pp. 16:22-17:1, AR Vol. I, Hr'g Ex. 8, p. 000348.

"cap" unduly restricts the amount of operating expenses that should be allowed for each well, and that the imposition of a "cap" is not supported by the Rule.

The Rule does not mention a "cap" or "maximum amount," and only provides for a single average to be used for purposes of calculating operating expenses. The Circuit Court rejected the Tax Department's justifications for use of a "cap," noting that "an average expressed and applied as a percentage renders the most accurate and equal expense allowance for each well. The dollar cap, on the other hand, cannot be applied proportionally to either wells with small gross receipts or wells with greater volume production, and therefore large gross receipts."[47] Any argument that the Tax Department's illegal "cap" acts as a safeguard was soundly rejected by the Circuit Court, which correctly determined that the use of the percentage yields the most accurate value based on the Tax Department's net receipts model, since use of the percentage reflects the fact that operating expenses fluctuate with a well's production volume. The Tax Department fails to explain what the cap "safeguards" against.

Respondent submitted proof of its actual operating expenses from 2014[48] to the Tax Department and the Lewis County BAA for consideration for tax year 2016, via testimonial

[47] The Tax Department's characterization of the possibility of operating expense for a well being "unlimited" is inaccurate. As noted by the Circuit Court, the use of a single percentage accounts for the differences in production for high volume and low volume wells. As production volume increases, the operating expenses also increase, and the use of the percentage captures this concept. The Tax Department proceeds to argue that is a "permissible construction" of W. Va. Code § 11-6K-1 *et seq.* to limit deductions of direct expenses as required under the legislative rule. However, the Tax Department has not, and cannot, point to language in the Rule that permits such a limitation, and the Circuit Court held accordingly. Furthermore, the Rule's requires operating expenses (and royalties paid) to be subtracted from gross receipts in order to arrive at net receipts for purposes of the yield capitalization model. The Tax Department concedes that "gross receipts are a function of the volume of the gas sold and the sales price received for the natural gas." Thus, the Business Court's decision to require operating expenses to be based on a percentage of gross receipts *does* take into account the volume of gas produced and sold.

[48] The Tax Department spends a lot of time discussing CNX's volume-based methodology of determining actual operating expenses per well. The relevance of this discussion is questionable in regards to the Circuit Court's decision, which was based entirely on eliminating the Tax Department's unlawful cap, and not on allowing CNX to claim its actual operating expenses.

evidence, and the introduction of detailed charts and documentation of actual operating expenses, with numbers specific to Lewis County.[49] Respondent's average operating costs for its conventional, vertical wells is approximately 37% of gross receipts, or $5,898 for tax year 2016.[50]

Respondent's operating expenses are comparable to operating expense information included in public comments from WVONGA in 2016, which calculated an operating expense percentage of 41% for calendar year 2015 for conventional well producers.[51] WVONGA's public comments were based on information provided by oil and gas producers who cover approximately 65% of production in West Virginia.[52]

Respondent contends that use of its actual operating expenses represents the best method to determine the fair market value for its producing wells, as required by the State Constitution[53] and West Virginia Code[54], and its initial valuation modification request was based on application of actual expenses in calculating the fair market value of Respondent's wells. Respondent's use of actual operating expenses is consistent with the Tax Department's past administrative notices in which it invited taxpayers to submit actual operating expense information in instances in which a producer's actual operating expenses exceed the "stated maximums" set by the Tax Department. This willingness to consider actual operating expenses demonstrates that the Tax Department recognized that the mass appraisal system does not always result in fair market value for producing wells, and was willing to consider actual operating expenses in those instances in order to arrive at the constitutionally and statutorily mandated "true and actual value." The Tax

[49] *See* AR Vol. III, Transcript, throughout; AR Vol. I, Hr'g Exs. 3, 4, 5, 6, pp. 000057-000297.
[50] AR Vol. III, Transcript pp. 13:20-14:23, 16:22-17:1; AR Vol. I, Hr'g Ex. 4, pp. 000180-82.
[51] AR Vol. I, Hr'g Ex. 9, pp. 000307-000311; AR Vol. III, Transcript pp. 13:20-14:23, 17:24-18:13.
[52] AR Vol. I, Hr'g Ex. 9, pp. 000307-000311.
[53] W. Va. Constitution, Article X, section 1
[54] W. Va. Code §§ 11-1C-10 (d) and 11-3-1 (a)

Department's witnesses testified at various hearings that nothing had changed in the West Virginia Code or the Rule that would lead the Tax Department to cease consideration of actual operating expenses. Instead, the Tax Department now apparently claims that it no longer has the authority to consider actual operating expenses, despite having done so for decades.[55] As noted above, section 4.3 of the Rule contemplates a single average annual industry operating expense for wells, but the Tax Department uses both a 30% average and a $5,000 cap for conventional, vertical wells. Additionally, as reflected in the annual valuation variables, the Tax Department uses different averages and caps for different types of wells, despite no express discussion of this methodology in the Rule. This has been the practice of the Tax Department for calculating operating expenses for years, with the Tax Department employing different averages and caps[56] for different well types in order to calculate what it considers the most accurate "true and actual" value for each well type. Clearly, the Tax Department has been willing to expand upon or interpret the rule in order to calculate what it deems the most accurate true and actual value for various types of wells, and its prior consideration of actual operating expenses reflects this. To now claim that actual operating expenses cannot be considered because the Rule does not

---

[55] In fact, the Tax Department's counsel, in a recent filing for another case involving the application of operating expenses for an oil and gas producer states that "the [taxpayer] failed to avail itself of procedures which may have allowed it to obtain additional deductions for its actual expenses for the wells whose valuation is at issue. Specifically the [taxpayer] did not provide its actual expenses for the last three years to the Tax Department for consideration in calculating the allowable operating expenses." *Denex Petroleum Corporation v. Mark Matkovich, West Virginia State Tax Commissioner, et al.*, Civil Action No. 16-AA-1, Barbour County Circuit (Respondents Mark Matkovich, West Virginia State Tax Commissioner and John Cutright, Assessor of Barbour County's Response to the Petitioner's Brief, filed September 29, 2016). This statement again demonstrates the Tax Department's recognition that actual operating expenses should be considered in some instances to calculate "true and actual value." While WV CSR § 110-1J-1 *et seq.* does not expressly address "actual operating expenses," it is important to remember that the overriding goal of the Rule is to arrive at "true and actual value," as required by the West Virginia Constitution and West Virginia Code. To ignore actual operating expense information when such information is necessary to calculate "true and actual value" is a violation of the Tax Commissioner's duty under W. Va. Code §§ 11-3-1 and 11-6K-1.

[56] Respondent has consistently argued that the cap is unsupported by law as it artificially limits the amount of operating expenses allowed per well, which violates the overriding goal of valuing the wells: to calculate a true and actual value.

expressly discuss the issue contradicts prior and current practices employed by the Tax Department.

In recognition of the Tax Department's "mass appraisal" system and the "average annual industry operating expenses" discussed under section 4.3 of the Rule, the Circuit Court used the 30% of gross receipts percentage used by the Tax Department, with the $5,000 cap- ***a cap that is not supported by the Rule and that does not allow for calculation of a true and actual value-*** lifted in order to modify the value of Respondent's wells. This value had not been discussed at the BAA hearing. The Petitioners appealed this matter to the West Virginia Supreme Court of Appeals prior to a remand of the matter to the Lewis County BAA, and the fair market value of the Respondent's wells for tax year 2016 based on application of the Tax Department's 30% average annual industry operating expense percentage to Respondent's gross receipts without the imposition of a cap has yet to be established. The Respondent acknowledges that the approach taken by the Circuit Court reflects the "mass appraisal" system of valuation contemplated by WV CSR § 110-1J-1 *et seq.*, and will agree with the fair market value that results from application of the average annual industry operating expense percentage to Respondent's gross receipts without the imposition of a cap for tax year 2016.

The Petitioners argue that the Circuit Court's ruling essentially transforms the ad valorem property tax structure's "net receipts" model into a "corporate net income tax framework." This is, of course, false. In reality, the Circuit Court's ruling results in a proper application of the net receipts model under the Rule by deducting from gross receipts all of the operating expenses that are ***directly related*** to the maintenance and production of the well. The Tax Department's interpretation and application of the Rule did not follow a true net receipts model, resulting in an overvaluation of the Respondent's producing wells. The Tax Department's claim that the Circuit

Court placed "great significance" on Respondent's actual operating expenses is simply unfounded. The Circuit Court's decision is based on the Tax Department's misapplication of the Rule through use of a "cap," and not on the application of the Respondent's actual operating expenses.

Furthermore, the Tax Department's argument that the Circuit Court created a "hybrid rule" is confusing. Apparently, the Tax Department is basing that characterization on language that this Court used in *Lee Trace, LLC v. Raynes*, 232 W. Va. 183, 751 S.E.2d 703 (2013). In that case, use of the term "hybrid" was logical, since the Berkeley County Board of Equalization and Review had required the Assessor to use both the cost approach and the income approach to determine the appraised value of an apartment complex. The Circuit Court did no such thing in this matter, and instead applied the Rule as written, without allowing the unlawful "cap" imposed by the Tax Department.

D. THE CIRCUIT COURT CORRECTLY DETERMINED THAT THE TAX COMMISSIONER'S VALUATION METHODOLOGY VIOLATES THE WEST VIRGINIA CONSTITUTION

The Circuit Court correctly held that The Tax Department's approach to calculating and applying operating expenses to producing natural gas wells through use of a "maximum amount" or "cap" violates the requirements under Article X, section 1 of the West Virginia Constitution that taxation be "equal and uniform throughout the state" and that both real and personal property "be taxed in proportion to its value to be ascertained as directed by law."[57]

The Tax Department's imposition of a "cap" results in different "average annual industry operating expense" percentages for conventional well producers, depending on the amount of annual gross receipts that a producer has for a particular well, resulting in property taxation that

[57] Generally, all property is assessed at sixty percent of its value. W. Va. Constitution, Article X, section 1b(A).

is not "equal and uniform" for different conventional producers.[58] For certain producers, a 30% "average annual industry operating expense" percentage is used for tax year 2016, whereby 30% of gross receipts for a particular well is used to calculate the operating expenses for the well. For other producers, the "maximum amount" or "cap" used by the Tax Department results in a much lower operating expense percentage being used.[59]

This Court has held that "[t]he equal and uniform clause of Section 1 of Article X of the West Virginia Constitution requires a taxpayer whose property is assessed at true and actual value to show more than the fact that other property is valued at less than true and actual value. To obtain relief, he must prove that the undervaluation was intentional and systematic."[60] The Tax Department's methodology of applying a 30% operating expense allowance for certain conventional well producers, while applying a much lower percentage for other conventional well producers, is intentional and systematic. This methodology is reflected in the Tax

---

[58] The Tax Department's personal income tax example is off base. The Rule values producing wells based on net income model wherein *all* operating expenses that are directly related to the maintenance and production of natural gas are to be deducted from gross receipts. West Virginia personal income taxes are not based on a true net income model. Rather, personal income taxes in West Virginia are based on federal adjusted gross income, with certain modifications and adjustments applied to arrive at West Virginia taxable income. The Tax Department's argument mistakenly states that West Virginia personal income tax allows for a "standard deduction," in lieu of itemized deductions. In fact, no "standard deduction" is allowed for West Virginia personal income taxes. Rather, West Virginia allows for a "personal exemption" that exempts $2,000 of income from taxation based on each of the qualifying members of a taxpayer's household. W. Va. Code § 11-21-16(a). The personal exemption has *zero relationship* to expenses incurred by the personal income taxpayer, and is not a standard deduction.

[59] Contrast the Tax Department's unconstitutional application of the "average annual industry operating expense" in the context of property taxation with the "transportation and transmission expense" allowance that the Tax Department allows for calculation of the severance tax, per WV CSR § 110-13A-4.8. In addition to allowing producers to submit "actual costs of transportation and transmission," per WV CSR § 110-13A-4.8.1, the transportation and transmission costs may be calculated by multiplying the gross proceeds of the natural gas severed and produced by 15%. WV CSR § 110-13A-4.8.4. This 15% transportation and transmission expense allowance is applied to producers regardless of the amount of gross receipts from the sale of the gas, with ***no maximum or cap applied***. Thus, not only does the Tax Department recognize that actual transportation and transmission expenses provide the most accurate calculation of the well head value of the natural gas, it applies the same 15% rate to all producers that choose that alternative for calculation of transportation and transportation expenses.

[60] Syl. Pt. 1, *Kline v. McCloud*, 174 W. Va. 369, 326 S.E.2d 715 (1984).

Department's final valuation variables for tax year 2016, where the 30% "Working Interest Expenses for Horizontal Producing Wells" with "Maximum Operating Expenses" of $5,000 is clearly spelled out.[61] This methodology is also set forth in Tax Department Administrative Notices released for tax year 2016.[62]

Here, Respondent's focus is not on whether other conventional well producers are undervalued, but on the fact that the operating expenses "cap" of $5,000 per well overvalues Respondent's wells. The "intentional and systematic" principle nonetheless applies, and Respondent has demonstrated that the overvaluation of its producing conventional wells is "intentional and systematic."[63]

As found by the Circuit Court, the Tax Department intentionally and systematically applies a different formula for calculating operating expenses depending on the amount of gross receipts for a particular well, in violation of the "equal and uniform" requirements under Article X, section 1 of the West Virginia Constitution. This Court has held:

> Where there is intentional discrimination against a taxpayer by knowingly applying a different formula to the computation of his taxes from that generally used for all other taxpayers in similar circumstances, such discrimination cannot be excused as a sporadic deviation and the aggrieved taxpayer is entitled to have its taxes computed in same manner and on same basis as the favored taxpayers.[64]

While the fact pattern in the *U.S. Steel* decision involved a situation where U.S. Steel was being singled out with a different formula than "all other taxpayers in similar circumstances," this matter involves a situation where the Tax Department is applying two systems of assessment to conventional well producers depending on the amount of gross receipts: 1) A net receipts model

---

[61] AR Vol. I, Hr'g Ex. 8, p. 000348; AR Vol. III, Transcript pp. 16:22-24.

[62] Administrative Notice 2016-08.

[63] *See also* Syl. Pt. 1, *In re Tax Assessments Against Pocahontas Land Corp.*, 158 W. Va. 229, 210 S.E.2d 641 (1974) (Where it is clear that the assessment has systematically discriminated against property owners and violated the equal and uniform provision, such assessments are illegal and cannot stand.)

[64] Syl. Pt. 2, *Town of Burnsville v. Cline*, 188 W. Va. 510, 425 S.E.2d 186 (1992) (Quoting Syl. Pt. 3, *Matter of U.S. Steel Corp.*, 165 W. Va. 373, 268 S.E.2d 128 (1980)).

using 30% of working interest receipts to calculate operating expenses for any well with working interest receipts of $16,666 or less for tax year 2016 and 2) a net receipts model using less than 30% of working interest receipts to calculate operating expenses (as a result of imposition of the $5,000 "cap") for any well with working interest receipts of more than $16,666 for tax year 2016. This methodology fails to satisfy the "equal and uniform" requirement of Article X, Section 1 of the West Virginia Constitution, and essentially singles out Respondent and other conventional well producers with wells that generate higher gross receipts on an annual basis by limiting operating expenses to $5,000 per well for tax year 2016.[65] As this Court has stated, "[i]t would be totally unacceptable to allow counties to use two systems of assessment, one for favored taxpayers and one for others."[66] In the year following the *U.S. Steel* decision, this Court recognized that "[t]he constitutional requirement of equal and uniform taxation means that as to classes of property, businesses, or incomes there shall be uniformity of taxation and tax upon all businesses of same class which is uniform as to that class of business is not unconstitutional."[67] The Court noted, however, that "[c]ourts have implemented this rule of equal treatment by

[65] The 30% or cap of $5,000 is applied to working interest revenue after being projected forward 18 months. In Lewis County, the production rate decline applied to conventional wells varies according to the formation, according to valuation variables published by the Tax Department. The $16,666 revenue threshold, for the sake of simplicity, was calculated by dividing the $5,000 cap by the operating expense percentage allowance of 30%.

Whether a well receives the full 30% operating allowance or whether the well is capped at $16,666 depends on whether working interest revenue is above or below the certain amounts, depending on formation, once the 18 month forward revenue projection and production decline rates are taken into consideration. If working interest revenue is below certain amounts, the operating expense applied is 30% of the revenue, and if the working interest revenue is above certain amounts, the allowance is capped at $5,000 and the actual operating expense allowance is much lower than the 30%.

Of the 863 conventional wells appealed by CNX in Lewis County, only 241 of them receive the benefit of the 30% operating expense allowance, while the other 622 wells incurred significantly more in operating expenses than were allowed by the Tax Department as a result of the cap.

[66] *U.S. Steel*, 165 W. Va. at 379, 268 S.E.2d at 132.
[67] *Capitol Cablevision Corp. v. Hardesty*, 168 W. Va. 631, 285 S.E.2d 412 (1981).

invalidating taxes falling unequally on business competitors who make the same product or offer the same service."[68] Again, the Tax Department's methodology results in overvaluation of certain conventional well producers (those with gross receipts per well of over $16,666 for tax year 2016) that produce the same product as other producers (those with gross receipts per well of $16,666 or less for tax year 2016). This methodology violates the West Virginia Constitution.

Additionally, to satisfy Article X, Section 1 of the West Virginia Constitution, property must "be taxed in ***proportion to its value*** to be ascertained as directed by law." (Emphasis added.) While the Constitution does not provide the methodology to value producing oil and natural gas properties, implicit in this language is that the Tax Department must adhere to the directions proscribed by the Legislature. The Tax Department is required, under the Rule, to value producing oil and natural gas property through application of a "net receipts" model. The most accurate method to satisfy the "net receipts" model involves a deduction of actual expenses from the gross receipts of producers, and the Tax Department has previously recognized this as evidenced by its past solicitation of such information from producers in prior administrative notices.

Further, West Virginia Code § 11-3-1 (a), requires that all property, except public service business property, be assessed annually as of July 1 at sixty percent of its *true and actual value*, which is defined as "the price for which such property would sell if voluntarily offered for sale by the owner thereof, upon such terms as such property, the value of which is sought to be ascertained, is usually sold, and not the price which might be realized if such property were sold

[68] *Id.* at 642, 419. *See also Killen v. Logan County Com'n*, 170 W. Va. 602, 295 S.E.2d 689 (1982) ("Since article 10, section 1 of the West Virginia Constitution requires equal and uniform taxation in all areas of the state, both the method and the result of taxation are essential to compliance with the constitution.")

at a forced sale." For the above-stated reasons, as determined by the Circuit Court, the Tax Department failed to assess Respondent's producing wells at their true and actual value.

In recognition of the Tax Department's "mass appraisal" system and the "average annual industry operating expenses" discussed under section 4.3 of the Rule, the Circuit Court used the 30% of gross receipts percentage used by the Tax Department, with the $5,000 cap- ***a cap that is not supported by the Rule and that does not allow for calculation of a true and actual value-*** lifted in order to modify the value of Respondent's wells. This value had not been discussed at the BAA hearing and, the value will need to be determined upon a remand to the BAA. Respondent continues to believe that the 30% allowance is not reflective of the actual operating expenses incurred by it and many other conventional well producers, and does not result in a valuation that represents "true and actual value" of its wells; however, applying the 30% of gross receipts percentage to all conventional well producers eliminates some of the Constitutional infirmities, and is a reasonable approximation of "true and actual value" until the Tax Department reevaluates its calculations.

E. THE CIRCUIT COURT CORRECTLY DETERMINED THAT THE TAX COMMISSIONER'S VALUATION METHODOLOGY VIOLATES THE UNITED STATES CONSTITUTION

The Tax Department's application of the Rule results in gross disparities in the assessed value of property in the same class, which violates the Equal Protection Clause under the Fourteenth Amendment to the United States Constitution.[69]

The United States Constitution guarantees citizens equal protection of the laws.[70]

[69] As noted in Justice Neely's dissent in *Kline v. McCloud*, 174 W. Va. 369, 326 S.E.2d 715 (1984), West Virginia's "equal and uniform provisions governing taxes is sub-species of the equal protection clause."
[70] U.S. Const. amend. XIV § 1. As noted by this Court in *Town of Burnsville*, supra: "It is well recognized in both State and federal law that tax rates, although different for different classes, must be equal and uniform within the individual class. In *Allegheny Pittsburgh Coal Co. v. County Commission of Webster County,* 488 U.S. 336, 109 S.Ct. 633, 102 L.Ed.2d 688 (1989) , the United States Supreme Court

As held by the Circuit Court, the Tax Department's methodology of applying the "net receipts" model under the Rule violates the Equal Protection Clause under the Fourteenth Amendment of the United States Constitution, since it creates two disparately taxed groups within the same class of taxpayers, i.e., conventional well producers. As noted throughout this brief, the Tax Department calculates operating expenses for certain conventional well producers based on 30% of gross receipts. For others, an operating expense percentage much less than 30% is used. The Tax Department has offered no plausible explanation for the application of its "net receipts" model whereby producers are treated so disparately. Clearly, producers that are allowed the 30% operating expense percentage have a substantially lower property tax burden, as a function of gross receipts, than producers that are allowed an operating expense percentage that is substantially lower than 30%. Application of wildly different operating expense percentages to these producers, through the use of the $5,000 "cap" violates the equal protection clause of the United States Constitution.

V. CONCLUSION

For the foregoing reasons, the Respondent respectfully requests that the Court affirm the Circuit Court of Lewis County Business Court Division's *Order Reversing the Lewis County Board of Assessment Appeals Upholding the Valuation of CNX's Gas Wells for the 2016 Tax Year*, and remand the matter to the Lewis County BAA in order to establish the fair market value

---

ruled that the Equal Protection Clause of the United States Constitution is applicable in some taxation cases: "The Equal Protection Clause 'applies only to taxation which in fact bears unequally on persons or property of the same class.' " *Id.* at 343, 109 S.Ct. at 637, 102 L.Ed.2d at 697 (citations omitted). "The equal protection clause ... protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class." *Id.* at 343, 109 S.Ct. at 637, 102 L.Ed.2d at 698 (citations omitted). The Court concluded that the Equal Protection Clause allows the state to divide different types of property into different classes, which are each assigned an appropriate tax burden. The differing tax rates are proper as long as the division and resulting tax burdens are not arbitrary or capricious." *Town of Burnsville v. Cline*, 188 W. Va. at 512, 425 S.E.2d at 188 (Footnote omitted).

of the wells by applying the 30% average annual industry operating expense percentage to Respondent's gross receipts without the imposition of a cap.

RESPONDENT

CONSOL ENERGY INC. DBA CNX GAS COMPANY LLC

BY COUNSEL

Craig A. Griffith (WVSB No. 8549)
John J. Meadows (WVSB No. 9442)
STEPTOE & JOHNSON PLLC
Post Office Box 1588
Charleston, West Virginia 25326
(304) 353-8000
Fax (304) 353-8180

CERTIFICATE OF SERVICE

I hereby certify that on the 2nd day of July, 2018, I served the foregoing "**Brief of the Respondent**" upon counsel of record by e-mail and first class mail as follows:

Counsel for Petitioners

L. Wayne Williams, Esq.
Office of the Attorney General
State Capitol, Building 1, Room W-345
1900 Kanawha Boulevard East
Charleston, West Virginia 25305
Counsel for Dale W. Steager, West Virginia State Tax Commissioner

John J. Meadows (WVSB No. 9442)